



A REPORT  
TO THE  
ARIZONA LEGISLATURE

Performance Audit Division

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Performance Audit

# Department of Environmental Quality—Underground Storage Tanks Financial Responsibility

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September • 2013  
REPORT NO. 13-06



**Debra K. Davenport**  
Auditor General

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**STATE OF ARIZONA**  
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DEPUTY AUDITOR GENERAL

September 3, 2013

Members of the Arizona Legislature

The Honorable Janice K. Brewer, Governor

Mr. Henry Darwin, Director  
Department of Environmental Quality

Transmitted herewith is a report of the Auditor General, *A Performance Audit of the Department of Environmental Quality—Underground Storage Tanks Financial Responsibility*. This report is in response to an October 26, 2010, resolution of the Joint Legislative Audit Committee. The performance audit was conducted as part of the sunset review process prescribed in Arizona Revised Statutes §41-2951 et seq. I am also transmitting within this report a copy of the Report Highlights for this audit to provide a quick summary for your convenience.

As outlined in its response, the Department of Environmental Quality agrees with all of the findings and plans to implement all of the recommendations directed at it.

My staff and I will be pleased to discuss or clarify items in the report.

Sincerely,

Debbie Davenport  
Auditor General

Attachment

# Department of Environmental Quality—Underground Storage Tanks Financial Responsibility

## REPORT HIGHLIGHTS PERFORMANCE AUDIT

### Our Conclusion

The Department of Environmental Quality (Department) is responsible for ensuring that owners and operators of petroleum underground storage tanks (USTs) comply with federal and state financial responsibility requirements. These requirements help ensure that UST owners and operators can pay to clean up leaks and spills and compensate third parties for bodily injury and any property damage incurred. Sites and/or operators of petroleum USTs include service stations, convenience stores, and local governments. The Department continues to fail to ensure that UST owners and operators meet financial responsibility requirements. Although the Department has begun to take steps to identify and address some of the weaknesses with its financial responsibility program, it should take additional steps, including developing policies and procedures to ensure UST owners and operators comply with financial responsibility requirements.



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## Department continues to fail to ensure that UST owners and operators meet financial responsibility requirements

**Financial responsibility requirements intended to minimize public cleanup costs**—To protect human health and the environment, federal and state laws require owners and operators of petroleum underground storage tanks (USTs) to have financial resources to clean up spills and leaks. These laws are intended to minimize the number of leaking USTs that are abandoned or “orphaned” by their owners and operators and to ensure that the polluter or responsible party, rather than the general public, bears the burden and cost of cleanup if needed. Federal and state government entities are exempt from the requirements. However, all others with regulated petroleum USTs, including local governments, must comply with the requirements.

There are 12 different mechanisms that owners and operators can use to demonstrate financial responsibility. These include insurance, self-insurance, letters of credit, and other mechanisms. According to department data, as of March 2013, most of the 2,423 facilities with regulated USTs in Arizona used insurance as their financial responsibility coverage mechanism. All USTs are supposed to be registered with the Department, and proof of financial responsibility must be provided at registration.

**Department continues to lack current financial responsibility evidence for many USTs**—Similar to findings in two prior audits, the Department continues to lack evidence of current financial responsibility for many USTs. The Office of the Auditor General’s 1998 audit report indicated that an estimated 53 percent of UST owners failed to demonstrate financial responsibility, while a 2004 audit report indicated that an estimated 38 percent of UST facilities failed to show compliance with the requirements. Likewise, our review of department data found that as many as 37 percent of UST facilities lacked evidence of current financial responsibility coverage as of March 20, 2013. Specifically, of the 2,423 facilities with regulated USTs, potentially as many as 145 facilities may never have had coverage, while another 746 facilities had expired financial responsibility coverage.

**State monies may be at risk**—When owners do not maintain financial responsibility, the State can end up paying the costs to clean up leaks and spills. The Department uses two main mechanisms to help pay for UST cleanup: the State Assurance Fund (SAF) and the Regulated Substances Fund (RSF), which are primarily funded through a 1 cent per gallon excise tax. As of April 2013, approximately \$335 million in SAF monies had been used to help clean up 2,664 sites with leaking USTs, an average of \$103,000 per site. However, the excise tax and the SAF are set to expire in December 2015. Further, according to department staff, many USTs may be approaching the end of their expected 30-year lifespan, after which the risk of leaks increases. This could pose a significant expense to the State if owners do

### Number and percent of USTs by age As of May 30, 2013

Years	Number of USTs	Percent of USTs
50+	36	<1%
40-49	189	3
30-39	676	10
20-29	2,935	43
10-19	2,000	29
0-9	955	14
Missing	<u>83</u>	<u>1</u>
Total	<u>6,874</u>	<u>100%</u>

not maintain financial responsibility.

**Weak department processes and controls over financial responsibility requirements**—The Department lacks adequate processes and controls to ensure UST owners and operators meet financial responsibility requirements. Specifically, the Department:

- Registered USTs without proof of financial responsibility as long as the USTs met other technical requirements such as spill and overflow protection. Department staff estimate that only 20 to 25 percent of UST registrations include proof of financial responsibility.
- Conducted only limited followup on facilities with expired financial responsibility. As of March 2013, 746 facilities had expired coverage; however, since November 2012, only 21 letters were sent to UST owners and operators notifying them of expired coverage.
- Did not follow up in instances where department data indicated the facility never had coverage.
- Provided general information to UST owners and operators about the requirement to have financial responsibility in the registration approval letter and annual registration tank invoice, but did not notify owners and operators of any noncompliance, and few owners and operators submitted updated financial responsibility documents.
- Rarely enforced financial responsibility requirements unless noncompliance was discovered during an inspection. Financial responsibility violations were cited in 40 percent of UST inspections in fiscal year 2012.
- Accepted documentation of financial responsibility that did not meet regulatory requirements.

In addition, the Department's database did not accurately reflect all facilities' financial responsibility coverage or lack of coverage, or had accurate information about facilities that are covered under a different name.

**Department has begun taking steps to address weaknesses, but additional actions needed**—The Department has hired an experienced manager to oversee the UST financial responsibility program and improve its processes. The program manager has begun implementing various actions to strengthen the program, including improving the usability of its database to monitor compliance with financial responsibility requirements; educating both internal and external stakeholders on financial responsibility requirements; leveraging partnership opportunities to facilitate its outreach activities; and developing a strategic plan to further improve the program, including initiating enforcement action in response to failure to submit evidence of financial responsibility rather than waiting on inspections.

The Department should take additional steps to ensure that UST owners and operators comply with financial responsibility requirements, including developing and implementing up-to-date written policies and procedures, developing and providing training to staff on required financial responsibility documentation, conducting routine review of staff's work, and improving communication and coordination between the registration and financial responsibility staff.

## Recommendations

The Department should:

- Continue its efforts to make program improvements;
- Develop and implement updated policies and procedures; and
- Ensure that staff accurately determine that evidence of financial responsibility meets requirements and take timely and appropriate action when owners and operators are found to be in noncompliance.

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concluded •

## INTRODUCTION

### Scope and Objectives

The Office of the Auditor General has conducted a performance audit of the Department of Environmental Quality (Department)—Underground Storage Tanks Financial Responsibility, pursuant to an October 26, 2010, resolution of the Joint Legislative Audit Committee. This audit is the second in a series of audits conducted as part of the sunset review process prescribed in Arizona Revised Statutes (A.R.S.) §41-2951 et seq and examines the Department's processes for ensuring that owners and operators of petroleum underground storage tanks comply with state and federal laws and regulations regarding financial responsibility for leaks and spills. The first audit focused on the Department's processes for monitoring and enforcing regulated facilities' compliance with state and federal environmental laws and regulations. The third audit will address the statutory sunset factors.

## Financial responsibility requirements intended to minimize public cleanup costs

To protect human health and the environment from the negative impacts of abandoned leaking underground storage tanks (USTs), federal and state laws require owners and operators of petroleum underground storage tanks to provide guarantees for the safe cleanup of these tanks (see textbox). These laws are intended to minimize the number of these sites that are abandoned or "orphaned" by their owners or operators, and to ensure that the polluter or responsible party bears the burden and costs of cleanup if needed rather than the general public. These requirements also provide an incentive for owners to locate, design, and operate their facilities in a manner that will minimize cleanup costs and reduce the likelihood of accidents and other incidents that may harm third parties.

**Underground storage tank**—A UST includes a tank and any underground piping connected to the tank that has at least 10 percent of its combined volume underground. Sites with petroleum USTs include:

- Marketers who sell gasoline to the public, such as service stations and convenience stores, and
- Nonmarketers who use tanks solely for their own needs, such as fleet service operators and local governments.

As of March 2013, there were approximately 213,000 sites with approximately 581,000 active USTs nation-wide, which are regulated by the UST technical regulations in the United States.

Source: A.R.S. §49-1001 and U.S. Environmental Protection Agency, Office of Underground Storage Tanks' overview of the federal UST program.

The U.S. Environmental Protection Agency's (EPA) Web site indicates that nearly 511,000 UST releases had been confirmed nation-wide as of March 2013. As a result of over a decade of work, 430,000 contaminated sites have been cleaned up. However, approximately 81,000 UST sites still need to be addressed. Some states have dedicated funding and programs that pay for some UST cleanup costs. Altogether, state fund programs spent an estimated \$1 billion annually to clean up UST leaks and spills, in addition to federal monies from the Leaking Underground Storage Tank Trust Fund and amounts paid by responsible parties.<sup>1</sup>

<sup>1</sup> The average annual amount spent by state fund programs to clean up UST leaks and spills was based on annual survey results published by the Association of State and Territorial Solid Waste Management on their Web site. The surveys were conducted by the Vermont Department of Environmental Conservation and showed that between 2000 and 2010, the state funds spent an estimated \$1 billion annually.



## Financial responsibility requirements

Owners and operators of petroleum USTs must meet financial responsibility requirements established by federal and state laws and regulations (see textbox).<sup>1</sup> These requirements do not apply to federal and state government entities whose debts are the debts of a state or the United States, such as the Arizona Department of Transportation or the U.S. Air Force. Local governments, however, must comply with the financial responsibility requirements. If the owner and operator are not the same, only one must meet the financial responsibility requirements, although both are liable for cleanup costs and fines in the event of noncompliance with the requirements. Federal regulations also require UST owners and operators to certify that they meet federal requirements for financial responsibility, and department rules require owners to submit and maintain updated certifications with the Department.

### Financial responsibility requirements

UST owners or operators must:

- Cover cleaning up spills and leaks and compensating third parties for bodily injury and property damage;
- Cover sudden and nonsudden accidental releases from the operation of petroleum underground storage tanks; and
- Provide the following in addition to any coverage for legal costs:
  - \$1 million per release for gas stations and other petroleum marketing facilities or tanks handling more than 10,000 gallons per month;
  - \$500,000 per release for other petroleum tanks;
  - \$1 million annual aggregate coverage for owners with up to 100 USTs; or
  - \$2 million annual aggregate coverage for owners with 101 or more USTs.

Source: Auditor General staff summary of Title 40 of the Code of Federal Regulations (CFR) §280.93.

## Allowable financial responsibility mechanisms

Federal UST financial responsibility regulations provide for eight different mechanisms that an owner or operator of a petroleum UST may use to meet the financial responsibility coverage requirements, including insurance, self-insurance, and a trust fund. Some states have developed additional EPA-approved mechanisms that may also be used by any UST owner or operator to demonstrate financial responsibility. For example, Arizona Administrative Code R18-12-310 allows owners and operators to cover cleanup, although not third-party compensation, with a certificate of deposit. In addition, there are four mechanisms that are specifically designed for use by local governments.

<sup>1</sup> The federal and state regulations are virtually identical, except that Arizona requires that financial responsibility documents be submitted to the Department and Arizona allows UST owners to use a certificate of deposit to demonstrate financial responsibility.

However, local governments are not limited to these four mechanisms (see Appendix A, Table 6, page a-1, for a description of the various financial responsibility mechanisms).<sup>1</sup>

As shown in Table 1, the most common financial responsibility coverage mechanism used by UST owners and operators in Arizona is insurance. Specifically, as of March 20, 2013, 78 percent of the facilities with regulated petroleum USTs used insurance as their financial responsibility coverage mechanism to pay for potential cleanup costs. To facilitate access to UST insurance, the EPA publishes a list of companies that have identified themselves as willing to sell UST insurance. As of July 2012, there were 16 companies listed; 13 indicated that their coverage area included Arizona.

Financial responsibility documentation and submission schedules vary by type of mechanism. For example, evidence of insurance may be an endorsement attached to an insurance policy or a certificate of insurance that summarizes the coverage. These documents must be provided to the Department whenever there is a change in the insurance policy, such as a change in the effective period or coverage amount. By comparison, local governments using a bond rating test must annually provide the Department with a letter from their chief financial officer certifying that they currently have general obligation bonds of \$1 million outstanding that meet a specified bond rating.

**Table 1: Number and percent of Arizona facilities with regulated petroleum USTs by financial responsibility mechanism As of March 20, 2013**

<b>Mechanism</b>	<b>Number of facilities<sup>1</sup></b>	<b>Percent of facilities</b>
Insurance	1,886	78%
No coverage <sup>2</sup>	208	9
Self-insurance	194	8
Local government bond rating test	49	2
Risk retention group coverage	37	2
Guarantee	21	<1
Coverage denied	12	<1
Local government fund	8	<1
Letter of credit	3	<1
Surety bond	3	<1
Local government financial test	<u>2</u>	<u>&lt;1</u>
Total	<u>2,423</u>	<u>100%</u>

<sup>1</sup> Of the 2,423 total facilities, 746 had expired financial responsibility (see Table 4, page 10).

<sup>2</sup> Sixty of the 208 facilities were state or federal government facilities that were exempt from the financial responsibility requirements. Auditors reviewed a small sample of the remaining 148 facilities and found that some had coverage. Specifically, auditors reviewed 4 such cases and found that 3 had coverage under other owner or operator names.

Source: Auditor General staff analysis of department UST financial responsibility data as of March 20, 2013.

## Department staff responsible for ensuring UST owners and operators meet financial responsibility requirements

The Department relies on several staff in its Waste Programs Division to ensure that UST owners and operators meet financial responsibility requirements. Specifically:

<sup>1</sup> Laws 2013, Ch. 244, established a UST study committee composed of legislators and stakeholders to consider and make recommendations on various issues relating to Arizona's UST program, including financial responsibility requirements and mechanisms for demonstrating financial responsibility. The committee is to present its findings and recommendations to the Governor, Senate President, and Speaker of the House by December 31, 2013.

- **UST registration staff**—All USTs must be registered with the Department within 30 days of the tank being brought into use.<sup>1</sup> As part of this registration, evidence of financial responsibility must be submitted to the Department. Department staff responsible for registering USTs receive financial responsibility documents and forward them to the financial responsibility program manager for review.
- **Financial responsibility staff**—The financial responsibility program manager is responsible for reviewing submitted documents to ensure they meet regulatory requirements. If the evidence provided meets the financial responsibility requirements, she should then update the department UST database to record the financial responsibility mechanism, the facilities and USTs covered by the mechanism, and the effective coverage dates. If the evidence does not meet requirements, she should contact the UST owner, operator, or insurer by letter, phone, or e-mail to request the correct information.
- **Inspectors**—In addition, as part of routine inspections of UST facilities, department inspectors check for financial responsibility compliance and initiate enforcement when UST owners and operators are out of compliance with the requirements.

Although various staff help ensure UST owners and operators meet financial responsibility requirements, as of May 2013, only the financial responsibility program manager was solely dedicated to this function. However, department officials reported that they plan to add more resources to the financial responsibility program by September 2013 through reallocating or hiring an additional staff person.

## Financial information

The Department uses two main mechanisms to help pay for UST cleanup: the State Assurance Fund (SAF) and the Regulated Substances Fund (RSF), which are primarily funded through an excise tax (see textbox on page 5). As shown in Table 2 (see page 6), between fiscal years 2009 and 2013, SAF revenues ranged from approximately \$28.8 million to \$37.2 million annually, while expenditures ranged from approximately \$6.1 million to \$29.3 million annually. Additionally, between fiscal years 2009 and 2012, legislatively required transfers from the SAF, primarily to the State General Fund, totaled nearly \$48.5 million. Finally, in fiscal year 2013, the Department transferred approximately \$50.5 million from the SAF to the RSF in accordance with Laws 2013, Ch. 244, which requires any monies in the SAF up to a maximum of \$60 million be transferred to the RSF.

As shown in Table 3 (see page 7), between fiscal years 2010 and 2013, department expenditures for UST cleanups have ranged from a total of approximately \$9.9 million to \$26.6 million annually. The large decline in expenditures in fiscal year 2012 resulted from the Department closing out most of its remaining obligations in fiscal year 2011 for releases that met the eligibility requirements for

<sup>1</sup> A.R.S. §49-1002(A) requires that UST owners submit notification to the Department, which the Department refers to as “registration.”

**Excise tax**—1 cent per gallon fuel tax established in 1990 by A.R.S. §49-1031. Laws 2013, Ch. 244, §5, repeals the tax effective December 2015.

**State Assurance Fund (SAF)**—The Legislature created the SAF in 1990 to help eligible UST owners and operators meet the potentially high costs of leaking UST cleanups and to fund the Department's cleanup of orphaned leaking USTs where the owner or operator could not be located or were not otherwise capable of performing cleanups. The SAF uses monies from the excise tax for these purposes. UST owners and operators are eligible for reimbursement through the SAF for leaks and spills that occurred and were reported by June 30, 2006, unless the leak or spill could not have been reported before that date with reasonable diligence. The owner or operator must apply by December 31, 2015, and must meet conditions including compliance with financial responsibility requirements. Monies cannot be used to pay for injuries to third parties. Laws 2013, Ch. 244, §5, repeals the SAF effective December 2015.

**Regulated Substances Fund (RSF)**—The Legislature created the RSF in 2004 to succeed the SAF in recognition of the long-term nature of many UST cleanups and the continuing need to clean up orphan USTs yet to be found. A.R.S. §49-1018 requires the Department to select the sites where it will use these monies based on risk to human health and the environment. Laws 2013, Ch. 244, require that any monies up to a maximum of \$60 million in the SAF are to be transferred into the RSF. Any monies in excess of the \$60 million are to be deposited into the state highway fund.

Source: Auditor General staff summary of A.R.S. §§49-1018, 49-1031, 1051, and 1052; Laws 2013, Ch. 244; and Arizona Department of Environmental Quality. (2009). *Underground Storage Tank Assurance Account liabilities report* (Publication # EQR 09-03). Phoenix, AZ: Author.

reimbursement under the SAF.<sup>1</sup> Consequently, the expenditures in fiscal years 2012 and 2013 are primarily for cleanup costs incurred by the Department's State Lead Program.

The State Lead Program cleans up leaking orphaned tanks, which are tanks whose owner cannot be located, because, for example, the owner is deceased. The State Lead Program also assumes cleanup responsibility for leaking tanks whose owners do not have the technical or financial capability to clean up the leaks or spills or are unwilling to do so (see Finding 1, page 11, for more information on the State Lead Program). If an owner is unwilling to conduct the cleanup required by the Department or is technically or financially incapable of conducting the cleanup, the State Lead Program may perform the cleanup and then attempt to recover the costs.

<sup>1</sup> Until the Legislature enacted Laws 2013, Ch. 244, releases had to be reported before July 1, 2006, to be eligible for reimbursement by the SAF. However, the 2013 legislation eliminated the 2006 reporting deadline for releases that could not have been reported by that date using reasonable diligence.

**Table 2: Schedule of State Assurance Fund revenues, expenditures, and changes in fund balance**  
**Fiscal years 2009 through 2013**  
**(In thousands)**  
**(Unaudited)**

	2009	2010	2011	2012	2013
<b>Revenues</b>					
Underground Storage Tank Revolving Fund <sup>1</sup>	\$ 29,206	\$ 29,059	\$ 28,849	\$ 37,171	\$ 29,406
<b>Expenditures and transfers</b>					
Personal services and related benefits	4,206	3,875	2,996	2,705	1,184
Professional and outside services	3,910	1,399	3,285	3,308	330
Travel	38	24	29	24	10
Aid to organizations and individuals	18,884	16,520	13,245	1,227	270
Other operating and equipment	186	375	362	94	3,634 <sup>2</sup>
Indirect costs <sup>3</sup>	2,092	1,885	1,475	1,234	625
Total expenditures	29,316	24,078	21,392	8,592	6,053
Transfers <sup>4</sup>	14,637	20,545	7,021	6,290	50,498
Total expenditures and transfers	43,953	44,623	28,413	14,882	56,551
Net change in fund balance	(14,747)	(15,564)	436	22,289	(27,145)
Fund balance, beginning of year	34,752	20,005	4,442	4,878	27,167
Fund balance, end of year	\$ 20,005	\$ 4,442	\$ 4,878	\$ 27,167	\$ 22

<sup>1</sup> Amount consists of the revenues allocated to the assurance account portion of the UST Revolving Fund in accordance with A.R.S. §49-1036. The UST Revolving Fund receives its revenue primarily from excise taxes.

<sup>2</sup> According to the Department, the large increase in fiscal year 2013 primarily relates to information and technology costs that were paid with a portion of the approximately \$6.1 million the Department spent for administrative costs as authorized by Laws 2012, Ch. 303, §14.

<sup>3</sup> Amount consists of administrative and support service costs that are allocated by the Department to its various divisions.

<sup>4</sup> Fiscal year 2009 through 2012 amounts primarily consists of monies transferred to the State General Fund in accordance with session laws. Fiscal year 2013 amount consists of transfers to the RSF in accordance with Laws 2013, Ch. 244, which requires any monies in the SAF up to a maximum of \$60 million be transferred to the RSF.

Source: Auditor General staff analysis of department-prepared financial information for fiscal years 2009 through 2013.

**Table 3: Schedule of cleanup costs for USTs**  
**Fiscal years 2010 through 2013**  
**(In thousands)**  
**(Unaudited)**

	2010	2011	2012	2013
<b>Revenues</b>				
Underground Storage Tank Revolving Fund <sup>1</sup>	\$ 24,078	\$ 21,240	\$ 8,394	\$ 1,468
Regulated Substances Fund <sup>2</sup>				8,512
Federal grants, reimbursements, and agreements <sup>3</sup>	2,546	2,581	1,529	1,165
Total revenues	<u>\$ 26,624</u>	<u>\$ 23,821</u>	<u>\$ 9,923</u>	<u>\$ 11,145</u>
<b>Expenditures</b>				
Personal services and related benefits	\$ 4,472	\$ 3,410	\$ 3,130	\$ 2,724
Professional and outside services	3,032	5,084	4,001	6,659
Travel	27	33	30	25
Aid to organizations and individuals	16,520	13,245	1,227	270
Other operating and equipment	383	371	111	53
Indirect costs <sup>4</sup>	2,190	1,678	1,424	1,414
Total expenditures	<u>\$ 26,624</u>	<u>\$ 23,821</u>	<u>\$ 9,923</u>	<u>\$ 11,145</u>

<sup>1</sup> Amount consists of the revenues allocated from the UST Revolving Fund in accordance with A.R.S. §49-1036 that were used for cleanup costs for USTs. The UST Revolving Fund receives its revenue primarily from excise taxes.

<sup>2</sup> Amount consists of the portion of the RSF monies that were used for cleanup costs for USTs.

<sup>3</sup> According to the Department, amounts include monies awarded to the Department through the American Reinvestment and Recovery Act that were used for cleanup of 26 facilities with contamination from leaking underground storage tanks. Specifically, approximately \$1.61 million, \$1.58 million, and \$32,800 were received and spent in fiscal year 2010, 2011, and 2012, respectively, for cleanup.

<sup>4</sup> Amount consists of administrative and support service costs that are allocated by the Department to its various divisions.

Source: Auditor General staff analysis of department-prepared financial information for fiscal years 2010 through 2013.



## FINDING 1

The Department of Environmental Quality (Department) continues to fail to ensure that underground storage tank (UST) owners and operators meet financial responsibility requirements that help ensure that they can pay to clean up leaks and spills and compensate third parties for bodily injury and property damage. Similar to prior audit findings, department records indicate that many UST facilities have expired coverage or lack coverage. Further, the department database may incorrectly show other facilities as having coverage when they do not. As a result, state monies have had to be used to pay for UST cleanup of leaks and spills. The Department has hired a new program manager who has begun taking action to address program weaknesses, and it should take additional steps to ensure that UST owners or operators meet financial responsibility requirements.

# Department continues to fail to ensure that underground storage tank owners and operators meet financial responsibility requirements

## Department continues to lack evidence of financial responsibility for many USTs

The Department continues to fail to ensure that UST owners and operators with regulated petroleum USTs have financial responsibility. UST owners and operators can demonstrate financial responsibility in several ways, as shown in Table 6 (see Appendix A, page a-1), although as of March 2013, most used insurance. However, similar to findings in audit reports issued by the Arizona Office of the Auditor General in 1998 and 2004, this audit found that many UST facilities lacked evidence of current financial responsibility.

Specifically, the Auditor General's 1998 report indicated that an estimated 53 percent of UST owners had not demonstrated compliance with financial responsibility requirements as of October 1997, while the Auditor General's 2004 report indicated that an estimated 38 percent of UST facilities failed to demonstrate compliance with the requirements as of January 2004. Likewise, auditors' review of department data found that as many as 37 percent of UST facilities may not have had current financial responsibility coverage as of March 20, 2013.<sup>1</sup> Specifically, of the 2,423 facilities with regulated USTs, potentially as many as 145 facilities may never have had coverage, while another 746 facilities had expired financial responsibility coverage (see Table 4, page 10). Of those facilities with expired coverage, 275 had not had financial responsibility coverage for more than 2 years. For example:

- One company, which had two open underground storage tanks at a mobile home park, had not provided the Department with proof of financial responsibility since its most recent coverage expired in April 2010.

<sup>1</sup> In general, the Department's data reliably reflected the information provided by the UST owners or operators on the type of financial responsibility mechanism used and its expiration date. Other data for UST facilities reported as having no coverage in the department database was found to be less reliable. According to the Department's database, 208 facilities had no coverage as of March 20, 2013, but 60 of these were state or federal facilities that are exempt from financial responsibility requirements. Further, auditors reviewed a small sample of the remaining 148 facilities and found that some had coverage. Specifically, auditors reviewed 4 such cases and found that 3 had coverage under other owner or operator names.



- One company, which owned gas stations, had not provided the Department with proof of financial responsibility for 17 of its facilities since its most recent coverage expired in April 2007. Although the company closed all of its gas stations, as of March 2013, it still had tanks at these

**Table 4: Length of expired financial responsibility coverage As of March 20, 2013**

Time expired	USTs with expired financial responsibility coverage		Percent of the 2,423 total UST facilities
	Number of UST facilities	Percent of UST facilities	
1-60 days	52	7%	2%
61-120 days	76	10	3
121-180 days	85	11	4
181-365 days	100	14	4
366 days-2 years	158	21	7
More than 2 years	<u>275</u>	<u>37</u>	<u>11</u>
Total	<u>746</u>	<u>100%</u>	<u>31%</u>

Source: Auditor General staff analysis of department financial responsibility data for total regulated facilities and facilities with expired financial responsibility coverage as of March 20, 2013.

locations that had not been formally closed or removed. Even if tanks are no longer operating, they still pose a risk because liquid may still sit in the tank, and the owner is required to continue to submit evidence of financial responsibility until the tank is properly closed or removed.

Further, some facilities the Department believes have coverage may not be covered because of the way the department database is updated. UST owners are required to have financial responsibility for all of their facilities, and although they may use one mechanism to cover all of their facilities, they can also use separate mechanisms to cover each of their facilities. However, in cases where a UST owner has multiple facilities, when staff update the financial responsibility mechanism for one facility, the database automatically updates all of the owner's remaining facilities with this same information (see textbox), even if that particular mechanism is not being used to cover all of the facilities.

## Lack of financial responsibility may place state monies at risk

Financial responsibility requirements help to ensure that UST owners can pay the costs of cleaning up leaks and spills and compensate third parties for damages incurred because of leaks or spills. In addition, according to the U.S. Environmental Protection Agency (EPA), the financial responsibility requirements may also provide an incentive to owners to implement operating practices that can prevent leaks and spills.<sup>1</sup> Although the incidence of leaks from USTs had decreased since improved tank standards were fully imposed in 1998, leaks

### Example of database problem that may result in erroneous financial responsibility coverage status information

In one case auditors reviewed, the owner had 49 facilities, and the database showed that all 49 facilities had current financial responsibility coverage. However, the Department had only one insurance certificate for the owner, and the certificate covered only one facility. The Department lacked evidence that the other 48 facilities had coverage. When staff updated the database with information for the one facility, the database automatically updated records for all of the owner's facilities.

Source: Auditor General staff review of financial responsibility files and data.

<sup>1</sup> U.S. Environmental Protection Agency. (2000). *Financial responsibility for underground storage tanks: A reference manual*. Washington, DC: Author.

and spills continue to be a problem. According to a 2011 report prepared for the EPA, leaks and spills continue to occur from tank piping, operational errors such as overfilling tanks, releases at the dispenser, and failure to properly maintain UST systems, which includes the tank, underground connected piping, impact valve, and connected underground ancillary equipment and containment system, if any.<sup>1</sup>

When owners do not maintain financial responsibility, the State can end up paying the costs to clean up leaks and spills. As of May 2013, there were 736 leaks and spills being cleaned up at 397 UST facilities in Arizona, including 163 leaks and spills at 86 UST facilities being cleaned up by the Department's State Lead Program. This program, authorized by Arizona Revised Statutes (A.R.S.) §49-1017, uses a combination of state UST excise tax monies and other monies to pay for cleanup of orphaned and abandoned tanks, as well as tank leaks or spills the owner is not technically or financially capable of cleaning up. Altogether, the Department estimated it had used \$60 million for such cleanups from July 1992 through January 2013. According to the Department, it costs approximately \$103,000, on average, to clean up a leak or spill. For example, the State's costs to clean up a site that had a leak in 1996 and another leak in 2006 totaled approximately \$113,000 as of December 2012 (see textbox for this and another example).

#### Leaking UST cleanup cost examples

1. According to department records, a northern Arizona trading post had a UST leak reported in July 1996 and another leak in June 2006. As required by state and federal regulations, the UST owner should have had at least \$500,000 in financial responsibility coverage for such incidents. However, the UST owner did not have this coverage, and aside from sending a letter in 2007 requesting evidence of financial responsibility, the Department did not take any action regarding this noncompliance. Between November 2006 and June 2009, the property owner submitted reimbursement requests to the Department totaling \$184,575.<sup>1</sup> The Department used the SAF to reimburse approximately \$88,000 of the property owner's costs, and the State Lead Program also spent approximately \$25,000 for cleanup at the site. By the time the cleanup was completed in December 2012, state expenditures for the cleanup totaled approximately \$113,000.
2. The owner of a Tempe gas station did not meet financial responsibility requirements before beginning to fill the station's USTs in April 2010. When a spill occurred, the owner had to apply to the Department's State Lead Program because she did not have the ability to pay for the cleanup. A department inspector learned about a nearly 10,000-gallon inventory discrepancy at the station during a May 2010 inspection. According to an assessment report completed in April 2012, there had been a release of gasoline, and both soil and groundwater were contaminated with volatile organic compounds such as benzene and toluene. The company that conducted the assessment estimated the total costs of cleanup will likely range from \$500,000 to \$1.5 million.

<sup>1</sup> Although A.R.S. §49-1052(F)(5) states that UST owners are not eligible for SAF reimbursement if they do not comply with financial responsibility requirements, A.R.S. §49-1052(I) allows a property owner who voluntarily takes responsibility for the cleanup to receive reimbursement.

Source: Auditor General staff analysis of information provided by the Department.

The State may be even more at risk in the future because an excise tax that can pay for some cleanups will expire in December 2015. A.R.S. §49-1031 established a 1-cent-per-gallon excise tax beginning in 1990 to help pay for UST clean-up costs. Two funds established to provide mechanisms

<sup>1</sup> Industrial Economics, Inc. (2011). *Assessment of the potential costs, benefits, and other impacts of the proposed revisions to EPA's underground storage tank regulations*. Cambridge, MA: Author.

**Table 5: Number and percent of USTs by age**  
**As of May 30, 2013**  
**(Unaudited)**

Years	Number of USTs	Percent of USTs
50+	36	<1%
40-49	189	3
30-39	676	10
20-29	2,935	43
10-19	2,000	29
0-9	955	14
Missing	<u>83</u>	<u>1</u>
Total	<u>6,874</u>	<u>100%</u>

Source: Auditor General staff analysis of department UST data as of May 30, 2013.

to help pay for cleanup of leaks and spills—the State Assurance Fund (SAF) and the Regulated Substances Fund (RSF)—receive monies from this excise tax. As of April 2013, approximately \$335 million in SAF monies had been used to help clean up 2,664 sites, an average of approximately \$103,000 per site for the 2,392 sites that had been fully addressed. Additionally, the Department is authorized by A.R.S. §49-1015.01 to use RSF monies to pay for cleanup of UST releases, including cases where an owner or operator cannot be found. However, the excise tax and the SAF are set to expire in December 2015. With the expiration of the SAF and the excise tax, financial responsibility becomes even more important to ensure prompt cleanup and third-party compensation to reduce the risk to human health and the environment posed by leaking USTs.

Finally, according to department staff, many USTs in Arizona may be approaching the end of their expected 30-year lifespan, after which the risk for leaks increases. As shown in Table 5, as of May 2013, 56 percent of USTs in Arizona were installed at least 20 years ago, including 13 percent that were 30 years or older. The average UST age in Arizona was 21 years. This could pose a significant expense for the State, especially if several of the facility owners lack financial responsibility.

## Department has weak processes and controls over financial responsibility requirements

The Department lacks adequate processes and controls to ensure that UST owners or operators meet financial responsibility requirements. Specifically, the Department:

- Registered USTs without evidence of financial responsibility**—The Department registered USTs without proof of financial responsibility as long as they met other technical requirements, such as leak detection and corrosion, spill, and overflow protection. All USTs must be registered with the Department within 30 days of the tank being brought into use, and Arizona Administrative Code R18-12-222 requires that evidence of appropriate financial responsibility be submitted as part of the registration process. However, according to UST registration staff, the Department approved the registration and sent a confirmation notice even if there was no evidence of financial responsibility as long as the other registration requirements were met. The Department did not reject the application if the financial responsibility requirement had not been met, nor did it notify the owner that his/her application was deficient when it lacked only proof of financial responsibility. In addition, the Department did not notify its own financial responsibility program manager of the new registration to enable her to follow up and obtain the required evidence. Department staff estimated that only approximately 20 to 25 percent of UST registration forms are submitted with evidence of financial responsibility.

- **Did not ensure that UST owners and operators maintained continuing financial responsibility**—The Department conducted limited followup on UST owners and operators of facilities with expired financial responsibility coverage. Although the Department sent letters to UST owners and operators of selected facilities with expired coverage notifying them that they have 90 days to obtain and provide evidence of current financial responsibility, very few were sent the letter, and facilities with long-expired coverage were skipped in the selection process. Specifically, the previous financial responsibility coordinator reported selecting and sending the letter to some facility owners and operators and following up with a phone call if necessary. However, only 21 letters were sent between November 2012 and March 2013, even though 746 facilities had expired coverage as of March 2013. The previous coordinator reported that she did not send the letters to UST owners and operators of facilities with older coverage expiration dates because she believed the tanks were likely no longer in use. However, as mentioned previously, unless the tanks have been formally closed or removed, they may still contain liquid and pose a risk to human health and the environment and are required to have financial responsibility coverage.
- **Did not follow up and resolve instances where it appeared that the UST owner had never obtained financial responsibility**—The Department has done even less regarding the facilities its database shows as having no coverage. Specifically, department staff were unable to explain the meaning of the “no coverage” status in the department database, and the facilities in this group were not included in those the Department selected to send letters to notifying the owners and operators that they had 90 days to obtain and provide evidence of current financial responsibility. Although auditors determined that some facilities in this group were exempt or had coverage under a different facility name, the Department had not tracked exempt facilities although the database had this capability, and had not reviewed the facilities to identify those that actually lacked coverage so it could then take steps to ensure the UST owners and operators obtained and provided evidence of financial responsibility.
- **Did not inform owners that their facilities lacked evidence of financial responsibility**—The Department included general information about financial responsibility requirements in the confirmation notice that it sent to UST owners notifying them that their UST registration has been approved and in the invoice letter the Department sent to remind owners that it was time to pay their annual UST registration fee. According to department staff, the invoice letters do not result in many owners submitting updated financial responsibility documents, and department staff reported uncertainty regarding the effectiveness of the confirmation notices. However, neither of these letters specifically notified facility owners if they were out of compliance with the financial responsibility requirements.
- **Rarely enforced financial responsibility requirements unless noncompliance discovered in an inspection**—The Department typically has not initiated enforcement action based on owners’ or operators’ failure to submit evidence of financial responsibility. Instead, if a facility lacked evidence of financial responsibility coverage during the Department’s regular on-site inspections, which are required every 3 years, the inspector initiated enforcement action for this violation along with any other violations discovered during the inspection. According to department data, the enforcement action resulted in many UST owners or operators coming back into compliance; however, not always in a timely manner. Financial responsibility violations

are among the most common identified by inspectors, occurring in 40 percent of UST inspections in fiscal year 2012.

- **Accepted financial responsibility evidence that did not meet requirements**—Auditors reviewed a random sample of 16 UST facility files representing facilities with current, expired, and missing coverage.<sup>1</sup> Auditors' review of the 5 UST facilities demonstrating current financial responsibility coverage found that the Department accepted documentation of financial responsibility that did not meet regulatory requirements designed to help ensure the owner or operator would be able to use the financial responsibility coverage to help pay for cleanup and third-party liability costs in case of a leak or spill. Specifically, two of these facility owners did not include the required listing of all the tanks and facilities covered by their financial responsibility mechanism. For example, one owner listed only 1 of its 49 facilities on the certificate of insurance. As a result, the insurance may not cover all of its facilities. Additionally, for 2 of the 3 facilities covered by insurance, the file did not include a documented endorsement or certificate of insurance worded as required by federal and state regulations, such as including a paragraph stating that the UST owner's bankruptcy does not relieve the insurer of liability to pay a claim. Absent this language, the facility may be inadequately covered in the event of a leak or spill. Further, none of the 16 facility files auditors reviewed, including 6 with expired coverage, contained a certificate of financial responsibility, which is required from the UST owner or operator to certify that they meet federal requirements for financial responsibility. The Department's new financial responsibility program manager reported that she also had noted problems with absent or inadequate financial responsibility documentation in many of the files she had reviewed. For example, she stated that she had not seen a certificate of financial responsibility in any of the files she had reviewed in her first 2 months in her position.
- **Did not ensure the accuracy of the financial responsibility data in its UST database**—Finally, the Department's database does not accurately reflect all facilities' financial responsibility coverage or lack of coverage, so the Department cannot use it to effectively identify facilities that lack coverage. Two problems previously discussed—department staff's not using the database's ability to reflect a facility's exempt status and the database's automatic updating of all of an owner's facilities when evidence for one facility is submitted—affect the database's usefulness. In addition, if a facility operator, not the owner, provides evidence of financial responsibility, the database is not programmed to reflect this coverage. Finally, if a facility has a change in owner name or is owned by a company that operates under more than one name, the database may not accurately reflect the coverage. For example, one gas station shown in the database as having no coverage was owned by a family that has several other gas stations in the State under a different company name and was covered under the other company name.

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<sup>1</sup> The 16 facility files auditors reviewed included 6 facilities with expired financial responsibility, 5 facilities with no financial responsibility, and 5 facilities with current financial responsibility. The 5 facilities with current financial responsibility included 3 facilities using insurance, 1 facility using self-insurance, and 1 facility using the local government bond rating test.

## Department has begun taking steps to identify and address weaknesses with UST financial responsibility

The Department has begun to take steps to identify and mitigate the problems with UST financial responsibility. In November 2012, the Department established a financial responsibility program manager position to oversee the program and improve processes, and filled the position with an experienced manager. As of May 2013, the new program manager had identified several problems with the financial responsibility program and begun to implement changes to address them. These changes include the following:

- **Recording UST owner and operator compliance only after complete and accurate evidence is provided**—The financial responsibility program manager reported that she does not enter financial responsibility information that is submitted to the Department into its UST database until determining that it is complete and accurate. If it is inadequate, she reported that she follows up with the owner, operator, or insurer typically by e-mail to explain why the information is incomplete and/or inaccurate and to request the appropriate documentation. Once the appropriate documentation is provided, she enters the financial responsibility coverage into the UST database.<sup>1</sup>
- **Improving database usefulness**—The financial responsibility program manager has begun working with department information technology staff to enhance the accuracy and availability of financial responsibility information so that staff can more effectively use it to ensure UST owners' and operators' compliance with financial responsibility requirements. As noted previously, the Department cannot rely on its database to identify noncompliant facilities. In June 2013, requests were submitted to the Department's information technology section to modify programming to capture financial responsibility information provided by operators and allow staff to update financial responsibility information by facility. In addition, a request was made to add a date field to track when financial responsibility documentation is received and to fix the database function that allows staff to delete a record when USTs have been permanently closed and no longer require financial responsibility or when an error has been made, such as linking the wrong owner identification number to a UST. Although the requests were logged into the Department's program change request tracking system, department staff report that they have a fairly low priority for resolution. As of June 11, 2013, there were 274 requests for program changes from throughout the Department listed in the tracking system.
- **Conducting outreach to stakeholders**—The financial responsibility program manager has begun reaching out to stakeholders to educate them about UST financial responsibility. Specifically, the program manager presented information on financial responsibility requirements and available mechanisms at the National Institute for Storage Tank Management conference held in Phoenix on August 1, 2013. This outreach activity was in addition to two prior stakeholder meetings held by the Department in 2012, specifically focused on financial responsibility.

<sup>1</sup> The program manager reported that although she realizes obtaining the certificate of financial responsibility is required and important as it is a self-certification that UST owner and operators comply with federal financial responsibility requirements, she is not currently requesting it because given the current resources available to her, her priority is to ensure UST owners and operators provide evidence of the actual mechanism that they are using to meet their financial responsibility obligations. However, as soon as the program is allocated additional resources, she will expand her followup to include the certificates.



According to the Department, during these meetings, participants were provided with information on UST financial responsibility requirements and mechanisms, including insurance, because it is the most commonly used mechanism in Arizona. Participants also had opportunities to speak with representatives of insurance companies and the Arizona Department of Insurance about available coverage options and issues related to coverage denials.

- **Clarifying financial responsibility requirements for UST inspection and compliance staff—**The financial responsibility program manager provided written clarification to UST inspection and compliance staff on financial responsibility requirements in May 2013, including the specific documentation needed to demonstrate compliance. This clarification provided inspectors and compliance staff with a clear and consistent understanding of the types of documentation they should review during inspections to ensure owners and operators have complied with financial responsibility requirements and when this documentation is submitted as proof that the UST owner or operator has returned to compliance with financial responsibility requirements.
- **Leveraging partnership opportunities—**The financial responsibility program manager met with representatives from the Arizona Petroleum Marketers Association (APMA) and the Petroleum Marketers Management Insurance Company (PMMIC) in July 2013 to discuss developing and providing UST operator training. The APMA is spearheading this effort with assistance from the PMMIC, who will serve as the primary trainer, and the financial responsibility program manager, who will assist with the financial responsibility component of the training. Department staff also continue to participate on the Association of State and Territorial Solid Waste Management Officials' State Funds—Financial Responsibility Task Force. According to the Department, this participation provides it with an opportunity to learn about compliance strategies and legislative efforts in other states, as well as overall UST financial responsibility program improvements made by other states.
- **Developing a strategic plan for the program—**Finally, the financial responsibility program manager is developing a strategic plan to improve the program in other ways. For example, she is proposing that the financial responsibility program directly initiate enforcement action in response to financial responsibility noncompliance instead of relying on inspectors to check for compliance during an inspection in order to speed up compliance with financial responsibility requirements. On June 27, 2013, the program manager submitted a draft strategic plan to her supervisor for review.

The Department should continue its efforts to improve its financial responsibility program. Specifically, it should continue to record UST owner and operator compliance in the UST database only after complete and accurate evidence of financial responsibility is received and follow up with the owner, operator, or insurer when it is not provided and ensure that the financial responsibility programming requests submitted in June 2013 are made. The Department should also continue to reach out to stakeholders and its inspection and compliance staff to educate them about financial responsibility requirements, including documentation needed to show compliance. In addition, it should continue to leverage partnership opportunities to facilitate its outreach activities and learn about strategies used in other states to improve financial responsibility compliance, which should be communicated to the Department's financial responsibility program manager. Finally, the Department should complete development of a strategic plan for the financial responsibility program and implement it.

## Additional actions needed to ensure financial responsibility

Despite these efforts, additional actions are needed to better ensure UST owners and operators comply with financial responsibility requirements. Specifically, the Department should take steps to ensure UST owners and operators obtain and maintain up-to-date financial responsibility, including developing policies and procedures that, among other things, ensure that UST registration is not approved without proof of financial responsibility, guide the review of proof of financial responsibility submitted by UST owners and operators, and require followup when this proof is insufficient. In addition, the Legislature should consider modifying statute to require insurance companies to notify the Department when UST insurance coverage is canceled or expires.

Department should take additional steps to ensure that UST owners meet financial responsibility requirements—In order to better ensure that UST owners and operators maintain appropriate, up-to-date financial responsibility, the Department should:

- **Develop updated policies and procedures to ensure compliance with rules and good business practices**—The Department lacks up-to-date written policies and procedures to guide the process for ensuring that UST owners and operators meet financial responsibility requirements. For example, consistent with its rules, these policies should specify that UST registration should require evidence of financial responsibility. In addition, they should define expectations for communication and coordination between the UST registration and UST financial responsibility functions, explain how to evaluate the evidence of financial responsibility to ensure it meets state and federal requirements, establish expectations and time frames for monitoring UST owner and operator compliance with the requirements, and specify actions to be taken when the requirements are not met.
- **Provide training to financial responsibility staff**—Financial responsibility requirements require staff to evaluate whether financial and legal documents meet requirements specified in federal and state regulations. In addition, staff must be able to reconcile UST facility ownership changes in order to ensure that a UST owner or operator's financial responsibility mechanism(s) reflect all of its UST facilities regulated in Arizona. Insufficient training on the required documentation needed to comply with financial responsibility requirements may have contributed to some of the problems auditors and the new financial responsibility program manager identified. To ensure that department staff understand the requirements and procedures for ensuring that UST owners meet requirements, the Department should provide or obtain training for any new staff who join the program and should consider periodically providing refresher training.
- **Implement supervisory review**—The Department does not have a process for routinely reviewing financial responsibility staff's work. Supervisory review could help ensure that staff have accurately determined whether evidence meets requirements and that staff have taken appropriate and timely actions when UST owners and operators have not submitted evidence of financial responsibility, when the evidence does not meet requirements, or when financial responsibility needs to be updated.



- **Improve coordination between registration and financial responsibility staff**—Although department UST registration staff forward financial responsibility documents to the financial responsibility program manager, they do not notify her when a UST registration is received that lacks evidence of financial responsibility. As noted previously, the Department should not register a UST without evidence of financial responsibility. However, even after making this change, coordination will be needed to inform the registration staff that the evidence meets requirements and ensure that the financial responsibility staff have accurate information about facility owners and operators.

Legislature should consider modifying statute so that insurers must notify the Department when they cancel UST coverage—In addition, the Legislature should consider modifying statute to require insurance companies to notify the Department when UST insurance coverage is canceled or expires. According to department data, owners and operators of 78 percent of the regulated UST facilities use insurance as their financial responsibility mechanism. At least one other state has a requirement for insurance companies to notify the state's environmental department about financial responsibility coverage changes. Specifically, Michigan requires insurers to notify its Department of Environmental Quality within 20 days after termination or nonrenewal of UST financial responsibility coverage. In Arizona, at least one type of insurance already has a similar requirement. Specifically, A.R.S. §23-961(I) requires insurers to notify the Industrial Commission if a workers' compensation policy is canceled or is not renewed.

## Recommendations:

- 1.1 The Department should continue its efforts to improve its financial responsibility program, including:
  - a. Recording UST owner and operator compliance with financial responsibility requirements in its database only after complete and accurate evidence of financial responsibility is received and following up with the owner, operator, or insurer to request the information when it is not provided;
  - b. Improving the database usefulness by modifying programming to capture financial responsibility provided by operators, allowing staff to update financial responsibility information by facility, tracking when financial responsibility documentation is received, and fixing the function that deletes records when USTs have been permanently closed and no longer require financial responsibility or when an error has been made, such as linking the wrong owner identification number to a UST;
  - c. Conducting outreach to educate stakeholders about financial responsibility requirements and mechanisms available to comply with the requirements;
  - d. Ensuring department inspection and compliance staff have a clear understanding of the financial responsibility requirements and documentation needed to comply with them;

- e. Leveraging partnership opportunities to provide outreach to stakeholders and learn about strategies used in other states to improve financial responsibility compliance, which should be communicated to the Department's financial responsibility program manager; and
  - f. Developing and implementing a strategic plan for the program.
- 1.2 The Department should develop and implement updated policies and procedures that:
- a. Specify that UST registration should not be approved without evidence of financial responsibility;
  - b. Define expectations for communication and coordination between the UST registration and UST financial responsibility functions;
  - c. Explain how to evaluate the evidence of financial responsibility to ensure it meets state and federal requirements;
  - d. Establish expectations and time frames for monitoring UST owner and operator compliance with financial responsibility requirements; and
  - e. Specify actions to be taken when a UST owner or operator does not meet the requirements.
- 1.3 The Department should ensure that its staff accurately determine whether financial responsibility evidence meets requirements and take appropriate and timely actions when UST owners and operators do not submit evidence of financial responsibility, when the evidence does not meet requirements, or when financial responsibility needs to be updated by:
- a. Developing and implementing training for financial responsibility staff, including refresher training, and
  - b. Developing and implementing supervisory review practices.
- 1.4 The Legislature should consider modifying statutes to require insurance companies to inform the Department before and/or after UST financial responsibility insurance is terminated, canceled, or not renewed.



## APPENDIX A

# Allowable financial responsibility mechanisms

Federal UST financial responsibility rules provide for eight different mechanisms that an owner or operator of a petroleum underground storage tank may use to meet the financial responsibility coverage requirements. In addition, there are four mechanisms that are specifically designed for use by local governments. However, local governments are not restricted to these four mechanisms. Table 6 summarizes these mechanisms.

**Table 6: Descriptions of allowable financial responsibility mechanisms**

Mechanism	Description	Availability
Self-insurance	The owner or operator assumes the risk of financial loss for conducting cleanup and paying for third-party liabilities of bodily injury or property damage. The owner's or operator's chief financial officer (CFO) must sign a letter certifying the company has at least \$10 million of tangible net worth among other requirements.	Anyone
Guarantee	A third party promises to fund a standby trust fund if the owner or operator fails to conduct cleanup or pay third-party liability claims. The guarantor must have a close business relationship with the owner or operator, or controlling interest in the business. The guarantor's CFO must sign a letter certifying the guarantor meets the same financial strength requirements as those for the self-insurance mechanism.	Anyone
Insurance and risk retention group coverage	The owner or operator obtains coverage from an insurance company that is authorized to offer such coverage. The policy must include specific language established in federal regulations.	Anyone
Surety bond	A third party (the surety) promises to either meet the unmet obligations or fund a standby trust fund if the owner or operator using the mechanism fails to conduct cleanup or pay third-party liability claims.	Anyone
Letter of credit	A third party promises to fund a standby trust fund if the owner or operator using the mechanism fails to conduct cleanup or pay third-party liability claims. A standby trust fund is a trust fund that is not yet funded but is otherwise ready to accept monies that can then be used to pay for cleanup and third-party compensation.	Anyone
State-required mechanism	The owner or operator may use state-developed mechanisms approved by the U.S. Environmental Protection Agency (EPA). Arizona Administrative Code R18-12-310 allows use of a Certificate of Deposit to pay for cleanup but an owner or operator must use a different mechanism to pay for third-party liability claims.	Anyone
State fund or other state assurance	The owner or operator may use an EPA-approved state fund or state assurance program if available.	Anyone
Trust fund	The owner or operator enters into an agreement with a trustee, which is usually a bank. If the owner or operator fails to conduct cleanup or pay third-party liabilities, the director of the regulatory agency can direct payments from the fund to perform the obligations not met.	Anyone
Local government bond rating test	The local government owner or operator uses outstanding issues of general obligation or revenue bonds and the ratings of those bonds to demonstrate that it can pay for cleanup and third-party liability claims. The local government must have at least \$1 million of outstanding general obligation or revenue bonds that are investment rated by Moody's or Standard & Poor's.	Local government
Local government financial test	The local government owner or operator assumes the risk of financial loss for conducting cleanup and paying for third-party liabilities of bodily injury or property damage. The CFO must sign a letter certifying that the local government meets the eligibility requirements.	Local government
Local government guarantee	A third party, which is either a state or another local government, agrees to honor the obligations of the local government if that government fails to conduct cleanup or pay third-party liability claims. The third party must have a close governmental relationship with the local government. The guarantor, if another local government, must meet all of the requirements established for using the local government bond rating test, financial test, or fund.	Local government
Local government fund	A local government owner or operator relies on its own funds to meet its obligations. Coverage is evidenced in a letter from the local government's CFO.	Local government

Source: Auditor General staff summary of 40 CFR §§280.90 through 280.115.

## APPENDIX B

## Methodology

This appendix provides information on the methods auditors used to meet the audit objectives.

This performance audit was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The Auditor General and staff express appreciation to the Department of Environmental Quality (Department) Director and staff members for their cooperation and assistance throughout the audit.

Auditors used various methods to study the issues addressed in this report. Auditors interviewed department officials and staff, as well as a representative from the Arizona Department of Insurance. Auditors also reviewed federal laws, regulations, and policies; and state statutes and administrative rules applicable to underground storage tank (UST) financial responsibility requirements. In addition, auditors reviewed department-prepared documents, including policies and procedures; and various external documents on financial responsibility, including documents prepared by the U.S. Environmental Protection Agency and the Association of State and Territorial Solid Waste Management Officials. Auditors also used the following specific methods to address the audit's objectives:

- To review the Department's processes for ensuring that owners and operators of USTs meet financial responsibility requirements, auditors observed department staff as they reviewed financial responsibility documentation; reviewed the financial responsibility program manager's list of issues to be addressed and proposed solutions; and obtained and analyzed department financial responsibility data as of March 20, 2013, to determine how many facilities with open or temporarily closed USTs had each type of financial responsibility coverage and how many had expired or no financial responsibility coverage. In addition to analyzing department financial responsibility data, auditors obtained and analyzed fiscal year 2012 enforcement data to determine how many UST inspections identified financial responsibility violations and unaudited UST installation data to determine the typical age of underground storage tanks in Arizona.
- To assess the reliability of department data, auditors examined department controls over the data including reviewing system help files, security, and program change procedures; and interviewed department staff knowledgeable about the data. Auditors also validated enforcement data as part of a prior audit on the Department's compliance management (see Arizona Auditor General Report No. 13-01). Finally, to further assess the reliability of the financial responsibility data, auditors verified the automated data against a random sample of 16 hard-copy files for facilities with regulated open or temporarily closed USTs as of March 20, 2013. The sample of 16 financial responsibility and UST files consisted of 6 facilities with expired coverage, 5 facilities shown in the database as having no coverage, and 5 facilities with current coverage using insurance, self-insurance, or a local government bond rating test. In general, the automated financial responsibility data appeared reliable except for the weaknesses discussed in Finding 1 (see pages 9 through 19).

- Auditors also reviewed existing Michigan and suggested Delaware UST regulatory language requiring insurers to notify the state environmental agency when insurance used to cover financial responsibility is canceled or expires.
- Auditors' work on internal controls focused on reviewing department processes for ensuring UST owners and operators comply with federal and state financial responsibility laws and regulations. Auditors' conclusions on internal controls are reported in Finding 1 (see pages 9 through 19).
- To develop information for the report's Introduction section, auditors compiled unaudited department-prepared financial information on state and federal monies used for UST cleanup efforts during fiscal years 2009 through 2013.

# AGENCY RESPONSE

AGENCY RESPONSE



Janice K. Brewer  
Governor

# ARIZONA DEPARTMENT OF ENVIRONMENTAL QUALITY

1110 West Washington Street • Phoenix, Arizona 85007  
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Henry R. Darwin  
Director

August 29, 2013

Debra K. Davenport  
Auditor General  
2910 N. 44<sup>th</sup> Street, Ste. 410  
Phoenix, AZ 85018

Dear Ms. Davenport:

This letter provides the Arizona Department of Environmental Quality's response to the August 19, 2013 revised preliminary report draft of the Underground Storage Tanks Financial Responsibility performance audit. We appreciate the diligence and hard work of the Auditor General's staff in completing this performance audit and their consideration of our feedback on the previous draft.

1.1 The Department should continue its efforts to improve its financial responsibility program, including:

a. Recording UST owner and operator compliance with financial responsibility requirements in its database only after complete and accurate evidence of financial responsibility is received and following up with the owner, operator, or insurer to request the information when it is not provided;

*Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.*

b. Improving the database usefulness by modifying programming to capture financial responsibility provided by operators, allowing staff to update financial responsibility information by facility, tracking when financial responsibility documentation is received, and fixing the function that deletes records when USTs have been permanently closed and no longer require financial responsibility or when an error has been made, such as linking the wrong owner identification number to a UST;

*Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.*

c. Conducting outreach to educate stakeholders about financial responsibility requirements and mechanisms available to comply with requirements;

*Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.*

d. Ensuring department inspection and compliance staff have a clear understanding of the financial responsibility requirements and documentation needed to comply with them;

*Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.*

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e. Leveraging partnership opportunities to provide outreach to stakeholders and learn about strategies used in other states to improve financial responsibility compliance, which should be communicated to the Department's financial responsibility program manager; and

*Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.*

f. Developing and implementing a strategic plan for the program.

*Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.*

1.2 The Department should develop and implement updated policies and procedures that:

a. Specify that UST registration should not be approved without evidence of financial responsibility;

*Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.*

b. Define expectations for communication and coordination between the UST registration and UST financial responsibility functions;

*Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.*

c. Explain how to evaluate the evidence of financial responsibility to ensure it meets state and federal requirements;

*Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.*

d. Establish expectations and time frames for monitoring UST owner and operator compliance with financial responsibility requirements; and

*Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.*

e. Specify actions to be taken when a UST owner or operator does not meet the requirements.

*Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.*

1.3 The Department should ensure that its staff accurately determine whether financial responsibility evidence meets requirements and take appropriate and timely action when UST owners and operators do not submit evidence of financial responsibility, when the evidence does not meet requirements, or when financial responsibility needs to be updated by:

- a. Developing and implementing training for financial responsibility staff, including refresher training, and

*Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.*

- b. Developing and implementing supervisory review practices.

*Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.*

On behalf of ADEQ, we appreciate the opportunity to respond and look forward to continue working productively with the Auditor General's staff on completion of the Department's remaining performance audits.

Sincerely,

Henry R. Darwin  
Director

## Performance Audit Division reports issued within the last 24 months

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<b>11-07</b>	Department of Corrections— Oversight of Security Operations	<b>12-03</b>	Arizona Board of Behavioral Health Examiners
<b>11-08</b>	Department of Corrections— Sunset Factors	<b>12-04</b>	Arizona State Parks Board
<b>11-09</b>	Arizona Department of Veterans' Services—Veterans' Donations and Military Family Relief Funds	<b>12-05</b>	Arizona State Schools for the Deaf and the Blind
<b>11-10</b>	Arizona Department of Veterans' Services and Arizona Veterans' Service Advisory Commission— Sunset Factors	<b>12-06</b>	Arizona Health Care Cost Containment System—Medicaid Fraud and Abuse Prevention, Detection, Investigation, and Recovery Processes
<b>11-11</b>	Arizona Board of Regents— Tuition Setting for Arizona Universities	<b>12-07</b>	Arizona Health Care Cost Containment System—Sunset Factors
<b>11-12</b>	Arizona Board of Regents— Sunset Factors	<b>13-01</b>	Department of Environmental Quality—Compliance Management
<b>11-13</b>	Department of Fire, Building and Life Safety	<b>13-02</b>	Arizona Board of Appraisal
<b>11-14</b>	Arizona Game and Fish Commission Heritage Fund	<b>13-03</b>	Arizona State Board of Physical Therapy
<b>12-01</b>	Arizona Health Care Cost Containment System— Coordination of Benefits	<b>13-04</b>	Registrar of Contractors
<b>12-02</b>	Arizona Health Care Cost Containment System—Medicaid Eligibility Determination	<b>13-05</b>	Arizona Department of Financial Institutions

## Future Performance Audit Division reports

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Arizona State Board of Pharmacy

Arizona State Board of Cosmetology

